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TRADE EXPANSION AND ECONOMIC INTEGRATION AMONG
DEVELOPING COUNTRIES, MEASURES TO BE TAKEN BY
DEVELOPING AND DEVELOPED COUNTRIES, INCLUDING REGIONAL,
SUB-REGIONAL AND INTER-REGIONAL ARRANGEMENTS

Regional payments arrangements in the ECAFE region:
recommendations of the Seminar of Financial Aspects
of Trade Expansion

Note by the UNCTAD Secretariat

In connexion with item 14 of the agenda, attention is drawn to the attached document containing a summary of the report of the Seminar on Financial Aspects of Trade Expansion, organized jointly by the secretariat of the United Nations Economic Commission for Asia and the Far East (ECAFE) and the United Nations Office of Technical Assistance, at Bangkok from 21 to 28 August 1967. It also contains the views and recommendations of the ECAFE Committee on Trade (eleventh session) on the subject. This document was submitted by the ECAFE secretariat for use by conference participants.

INTRODUCTION

1. In pursuance of the resolution on Asian economic co-operation adopted at the first Ministerial Conference on Asian Economic Co-operation held at Manila in December 1963, a Working Group of Experts on Trade Liberalization was convened in 1964 to recommend an acceptable programme of trade liberalization including removal of quantitative restrictions and tariff reductions within countries of the ECAFE region. The Group recommended various trade liberalization measures which could very well be taken by the countries of the region and observed that such measures would result in a more rapid growth of intra-regional trade if they were accompanied by some form of payments arrangement with credit facilities.
2. The second Ministerial Conference on Asian Economic Co-operation held at Manila in December 1965 adopted a resolution on dynamic Asian economic co-operation, recommending that a study group be constituted from among the regional countries to examine financial aspects of trade expansion and the need for a payments arrangement to prevent imbalances likely to arise from expanded intra-regional trade. The Commission, in its resolution 66(XXII) on regional trade co-operation, welcomed the recommendation of the second Ministerial Conference and called upon Governments of member countries of the region to redouble their efforts to foster co-operation on both a regional and sub-regional basis in the field of trade, by finding practical ways of applying appropriate trade liberalization measures and by making the necessary preparations for convening a meeting of representatives of interested countries of the region under the auspices of ECAFE to establish guide-lines for meaningful bilateral and multilateral consultations among themselves.
3. The Committee on Trade at its tenth session held in February 1967 considered the secretariat proposal to convene a Seminar on Financial Aspects of Trade Expansion in 1967 and to prepare a study on regional payments arrangements for examination by experts at the Seminar. The Committee recommended that the study should contain several alternative schemes covering such facilities as a simple clearing arrangement, a reserve fund and various types of credit arrangements, on both a regional and sub-regional basis.

4. In accordance with the above resolutions and recommendations, the Seminar on Financial Aspects of Trade Expansion was jointly organized at Bangkok, Thailand, from 21 to 28 August 1967 by ECAFE and the United Nations Office of Technical Co-operation. Experts from Afghanistan, Australia, Ceylon, India, Indonesia, Iran, Japan, Republic of Korea, Laos, Nepal, New Zealand, Philippines, Thailand and Republic of Viet-Nam participated in it in their personal capacity and not as government representatives. Representatives from the International Monetary Fund and the Asian Development Bank attended the Seminar in a consultative capacity.
5. The Seminar recognized that, with the formidable economic problems confronting some of the regional ECAFE countries, the financial aspects of trade expansion are one facet of economic co-operation which merits attention. The countries may have to consider concurrently other forms of mutual help and co-operation which are conducive to regional growth such as co-ordination of production policies and trade liberalization measures.
6. The Seminar had full discussions on alternative schemes of payments arrangements, including a simple clearing system and a payments union with credit extension and reserve arrangements. As the basis for the discussion, a study on "Alternative payments arrangements for the ECAFE region" TRADE/TE/1 and another on "Payments arrangements within the ECAFE region" TRADE/TE/9 had been prepared by Mr. J. R. Gunn and Professor Robert Triffin, respectively, who also participated in the Seminar as discussion leaders. A number of background papers were also circulated to the participants. Having taken note of the relevant experience and developments relating to payments arrangements in other regions, the Seminar examined in detail the various alternative proposals for the ECAFE region, as given in the two studies. The results of the examination and recommendations are given in the following paragraphs.

I. A SIMPLE CLEARING UNION

7. The Seminar took note that, in some regions of the world, particularly Central America, regional clearing arrangements had facilitated the adoption and implementation of other measures of economic co-operation and trade liberalization which contributed strongly to expansion and diversification of production and trade in these areas. While a quantitative estimate was not possible, it was reasonable to expect that, in the ECAFE region too, the introduction of appropriate clearing arrangements might make a positive contribution in this direction. In examining the scope for clearing arrangements, the Seminar also took note of the relatively high volume of intra-regional trade in the aggregate global trade of the countries of the ECAFE region, as compared with those in other developing regions.

8. Some participants expressed concern that the introduction of a clearing scheme might, in the case of some countries with de facto convertibility, require or encourage the restoration of exchange controls and reduce access to international financial markets. Other participants felt that it was possible to introduce a clearing union of a simple character which would not reduce the advantages currently available to participating countries through the use of conventional international banking arrangements, but which would rather supplement the existing facilities.

9. The Seminar recognized that one of the principal benefits to be derived from a clearing union would be to bring about a closer degree of consultation and collaboration on trade and financial matters among participating countries and to foster such co-operation further in the wider sphere of economic development. A clearing system would doubtless provide valuable opportunities for the monetary authorities to establish closer relationships and could result in improved co-ordination of monetary and fiscal policies within the region. Such co-ordination would significantly promote sound regional economic growth and trade expansion. More specifically it was recognized that intra-regional transactions which were now settled through traditional modes of payment involving hard currencies could be multilaterally compensated by being channelled through a clearing union. This would enable the countries of the region to use more effectively their scarce international reserves.

10. Further, it was expected that the reduction in the number of foreign exchange transactions as a result of multilateral compensations and periodic settlements would lead to some savings in servicing costs in terms of foreign exchange. Final judgement on this point can be formed only after details of the proposed system have reached a more advanced stage.

The types of transactions that should be settled through a clearing union

11. It was generally agreed that all international payments both capital and current could be covered by a clearing union, although specific types of capital transactions may be excluded by general agreement. One participant raised the special problems related to the settlement for petroleum exports. The Seminar noted this and the general view was that commodity exceptions were undesirable and should be avoided; however, a satisfactory way of meeting this problem should be sought.

Should the scheme be mandatory or optional?

12. It was generally recognized that it must be left to each participating member country to decide whether the use of the clearing system should be mandatory or optional insofar as the private trade was concerned. It was recognized that a system which left the option of using the clearing union in the hands of normal commercial banks would permit the use of mutually advantageous commercial credit facilities currently available.

Geographical composition

13. The Seminar agreed that the actual composition of regional or even sub-regional groupings was of course dependent on the willingness of governments to enter into such arrangements. However it was recognized that a larger group involving a greater absolute amount of compensable trade would be superior to a smaller one. Further the inclusion of countries with strong over-all balance of payments or reserve positions would be essential to the successful operation of any clearing or credit arrangements. On the other hand some participants suggested that, if differences of conditions prevented the participation of some countries, such a scheme could usefully be initiated even with a more limited membership.

Settlement periods and interim finance

14. Settlement at monthly intervals was considered a satisfactory basis at the initial stage of a clearing arrangement. Suitable interest rates should be calculated on daily debit or credit balances and added to the monthly settlement positions. Debtor countries should be required to settle their net positions two or three working days before payments were due to creditors. Such an arrangement would avoid the need for the clearing union to carry large working reserves.
15. The Seminar also examined whether ceilings on the aggregate credit and debit positions of member countries in the clearing union were desirable. The general view however was that a ceiling arrangement would be operationally cumbersome and could be avoided by making the period between settlements appropriately short. This however did not remove the doubts of some participants as to whether ceilings could be avoided.

Unit of account, par values and guarantee provisions

16. It was agreed that all accounts of the clearing union should be kept in a common unit of account of the EUP type. For purposes of clearing, wherever possible, national currencies would have fixed parities in terms of this unit of account. Where a par value had been declared to the IMF and was fully effective, the parity of the national currency in terms of the unit of account would be based on this par value. Where the par value was not effective or a par value had not been declared to the IMF but a fixed exchange rate was applied to all foreign exchange transactions, the parity of the national currency in terms of the unit of account would be based on this rate of exchange. In both cases, the parity so established should be guaranteed by the government concerned as a protection against possible changes in the external value of its currency.
17. Where a parity of the national currency in terms of the unit of account could not be established because of the existency of multiple currency practices or other considerations, the values of transactions to be cleared through the union should be expressed in terms of an international currency such as the US dollar. These values could then be converted into units of account.

Existing bilateral agreements

18. The Seminar agreed that, in the case of countries operating bilateral payments arrangements joining a clearing union, the existing bilateral arrangements between such countries should be merged in the clearing, thereby effectively multilateralizing them.

Operational costs

19. The Seminar agreed that the most equitable method of apportioning the operational costs, which were expected to be very small in any case, would be to distribute them among member countries on a pro rata basis according to total turnovers of transactions and/or by equivalent interest differentials between credits and debits.

Organization

20. The management of the clearing union, it was agreed, should be placed in the hands of a managing board consisting of five to seven members depending on the number of countries participating. The countries with greater recourse to the clearing facilities of the union should have the right to nominate permanent representatives while the other members could nominate jointly the remaining members of the board on a rotating basis.

21. The accounting, settlement and secretarial functions of the union could most satisfactorily be lodged with an institution such as the Asian Development Bank or the central bank of a major participating country.

Guarantees against default

22. The Seminar recognized the importance of having adequate safeguards against possible defaults. In this connexion, it was agreed that all countries should participate in a joint and solidary guarantee against any losses arising from default. Strong additional guarantees could be provided by suspending the defaulting country from any access to the credits of the clearing while requiring all other countries to channel through the clearing union all payments to the defaulting member until its outstanding debt was wiped out in full.

Arbitration

23. In the event of a dispute, the likelihood of which was extremely remote, a conventional type of arbitration panel should be appointed to resolve the issue.

II. PAYMENTS AND RESERVE ARRANGEMENTS

24. The Seminar examined the subject of payments and reserve arrangements and based its discussions on the proposals given in models A and B in document TRADE/TE/1 and the proposed reserve fund described in document TRADE/TE/9. With regard to proposed arrangements for the extension of credit beyond the settlement dates as provided for in the clearing scheme, the participants expressed a wide range of opinions and varying degrees of support for schemes for providing mutual credits, beyond interim finance, to enable countries to finance temporary fluctuations in payments balances associated with the implementation of a programme of trade liberalization within the region.
25. A scheme of credits geared to a programme of trade liberalization would seem to be more acceptable to countries which have made most progress towards trade liberalization and currency convertibility, since it would help other countries accelerate their own progress in the same direction.
26. Several participants expressed the view that any system of credits for the region should have safeguards for avoiding persistent debtor and creditor situations and for dealing with such situations as they emerge. The participant of one regional surplus country, which was in any case providing considerable credits to the region, maintained that the change of trade structure which is fundamental to the development of the region is better achieved by the extension of credit on a private basis such as deferred payments and long-term investment credits.
27. Without reaching any final decision on the scheme as a whole the Seminar arrived at the following conclusions with regard to the technical aspects of a payments scheme.

Interest and guarantee provisions

28. It was unanimously agreed that interest and guarantee provisions on mutual credits must be adequate to induce potential lenders to extend the credits necessary for the effective functioning of the system and without which it could not operate.

29. Credits should earn interest at a rate at least equal to that earned by comparable investments in major money markets, primarily New York and London. Debtors should pay a slightly higher rate (say 1/4 or 1/8% more) in order to defray administrative costs; even this rate would be lower than that applicable to similar borrowings in foreign money markets.
30. Guarantees against exchange risks would involve the denomination of the credits either in US dollars or, preferably, in a regional unit of account similar to that of EPU.
31. Credits should carry the joint and solidary guarantee of all members against default by any one of them.
32. The further guarantees suggested earlier in part I with reference to a clearing union would ensure the rapid wiping out of defaults that might arise.
33. The combination of the above provisions and possibly some other safeguards should enable prospective creditors to regard their credits to the system as being as safe and attractive as any alternative investment of such funds in foreign money markets.

Lending criteria

34. The Seminar discussed whether lending commitments should be based on:
- (a) intra-regional trade surpluses;
 - (b) intra-regional payments surpluses, including the impact of non-trading transactions as well;
 - (c) over-all balance of payments and reserve positions.

It was generally agreed that the last criterion would be either the only one acceptable to creditors - and to the IMF - or would have to be introduced as a necessary qualification to any criterion based on intra-regional positions alone.

Borrowing criteria

35. The same question arose in this connexion and it was generally agreed that over-all criteria would also be necessary either as a substitute or as a qualification to regional criteria.

36. The relationship between credits provided on the basis of over-all criteria and intra-regional trade liberalization should be emphasized by linking borrowing facilities to the acceptance and implementation of trade liberalization commitments. Credits should be designed to protect the over-all balance of payments and reserve position of members against the unpredictable impact of regional trade liberalization.
37. Some participants however suggested that one way of establishing such a link directly and firmly would be to confine the credits to imbalances arising in the incremental trade of the countries of the region, inter-se, which would also have the advantages of limited financial requirements and of tackling the problem of having to finance persistent imbalances due to structural characteristics.
38. It was generally agreed that a discretionary system of lending was preferable in principle but it was conceded that, given the limited experience of regional countries in mutual co-operation in monetary affairs, a system of automatic credit was the more practical possibility for a start, but with loans limited to short periods and modest amounts.
39. Some participants suggested that, if specific criteria could be prescribed to ensure that credits were extended only for the purposes in view and in the appropriate amounts and that provision was made for their amortization strictly according to a prescribed schedule, a practical via media between complete automaticity and complete discretion could be found.
40. In the application of any discretionary lending scheme regional criteria and policy conditions should be co-ordinated with those of the International Monetary Fund and should benefit from its long and valuable experience in this respect. The assistance of the Fund should also be sought in the practical operation of the system.

Repayment criteria

41. It was agreed that borrowing countries should use any later surpluses to repay the credits temporarily extended to them. If this were to prove insufficient to assure prompt and full repayment, contractual amortization provisions - by monthly or quarterly instalments - should be used, in addition, to ensure repayment within a reasonable period.

Domestic and regional currency provisions

42. With regard to Model B of document TRADE/TE/1, objections were raised to the partial settlement of regional deficits in domestic currencies. The view was expressed that such a scheme introduces an element of bilateralism into what was intended to be an essentially multilateral relationship - viz., a regional payments scheme.
43. It was agreed that the concept of a regional currency backed by large amounts of inconvertible currencies for the retirement of which no clear provision was indicated would not be acceptable.

Effects on reserves

44. One of the questions raised was whether the diversion of funds held as reserves in major money markets to regional investments might not have the effect of reducing access to credit in such markets. Other participants observed that the maximum order of magnitude involved (3 to 5% at most in Professor Triffin's proposals) would be too small to have any substantial effect of this sort, and that the contribution of the system to the monetary stability of member countries would, on the other hand, make them more credit worthy in the eyes of foreign lenders and increase the willingness of the latter to invest in the ECAFE region.
45. With regard to the risks of exchange depreciation and of declines in the market value of investments to which international reserves are subject, it was also observed that the collective holding of reserves would not enhance such risks. In fact to the extent that a regional reserve fund could hold a broader spectrum of currencies and a more diversified portfolio of investments than an individual country could afford to do, there would be a reduction of both exchange and market risks, as in the case of an investment trust.

46. The above arguments were felt to apply with equal force to the scope for the enhancement of earnings from international reserves in so far as such reserves were held in a collective form. Furthermore, since the total amount of reserves required to be kept in a completely liquid form would be smaller in respect of a collective holding of reserves, the earning capacity of the reserves would be further enhanced. Also, to the extent that the deficits of some members were matched by the corresponding surpluses of others, the collective fund would provide for mutual settlement without a transfer of reserves between them, thereby saving the costs of such transfers.
47. Some participants, however, were not fully convinced by the arguments stated in paragraphs 44 to 46 above and expressed a desire that further studies be undertaken.
48. It was observed that a simulation exercise based on the statistics of the period 1959-1966 indicated that the net loans outstanding from members to the reserve fund, which would determine the maximum scope of default, were exceedingly small. Nevertheless it was agreed that persistent surplus countries which would be the principal depositors in a reserve fund would need the assurance of reasonable safeguards and guarantees as well as simple recovery procedures for such a scheme to be acceptable to them.
49. It was considered that regional co-operation through a reserve fund arrangement of the type suggested in Professor Triffin's paper would not run contrary to international co-operation in monetary affairs, because the objectives of the former were limited. Furthermore, to the extent that problems of liquidity were settled on a regional basis, pressures on world liquidity arrangements would be reduced.
50. The Seminar also noted that simple regional reserve fund arrangements had been recommended by the group of experts appointed by UNCTAD (TRADE/TE/6).

III. CONCLUSIONS AND RECOMMENDATIONS

51. Subject to the reservations and qualifications expressed in the body of the report, the Seminar reached the following conclusions:

(a) A simple clearing union, with monthly settlements, would be of benefit to member countries provided that participating countries offered traders and banks the option of using the traditional modes of settlement or additional ones to be established.

(b) Longer term credit commitments and facilities, while aiming primarily at supporting intra-regional trade liberalization, should be geared to the over-all balance of payments and reserve position of members, rather than to intra-regional surpluses and deficits as such.

(c) The provision of such credits would shift towards the region a small portion of monetary reserves which were currently invested entirely outside the region.

(d) Interest earnings and various safeguards including guarantees against exchange risks, default, illiquidity and inconvertibility would be essential to obtain the assent of lenders to such a system.

(e) As far as borrowing was concerned, any large credits should be discretionary rather than automatic so as to avoid any abuse of the system to finance persistent deficits and elude necessary pressures for balance of payments readjustment. Modest automatic credits might nevertheless be provided to initiate the system until operational contacts among members had made it possible to develop a workable forum for reaching collective decisions on the purposes and conditions and multilateral surveillance of discretionary credits.

52. The Seminar recommended that a study of the existing international banking and credit facilities available to the region be undertaken, in co-operation with IMF, with a view to evaluating whether they adequately served the current and potential trade needs of the region.

53. The Seminar also recommended that the secretariat undertake further detailed study of the trade and commodity structure of developing member countries with a view to identifying the products in which trade could be expanded if a programme of trade liberalization linked with some clearing or payment arrangements were introduced.

54. The Seminar recommended that the secretariat initiate consultations with central banks, commercial banks, trade organizations, governmental and related bodies, with a view to stimulating their interest in undertaking an investigation into all aspects of clearing and payments arrangements. Any clearing and credit scheme would raise many questions calling for careful appraisal and effective safeguards against possible dangers and abuses. The Seminar recommended that these problems be urgently studied in each member country, with the help of the expertise available within and outside the government. If a sufficient number of governments were to reach positive conclusions as a result of these studies, a committee of government and central bank officials and financial experts should be convened at an early date to formulate concrete proposals. Technical assistance from IMF and distinguished economists in the field of international finance should be sought in this matter. In this connexion the Seminar expressed its appreciation of the offer made by the International Monetary Fund to assist the regional member countries of ECAFE in the formulation of practical schemes of regional monetary co-operation.

IV. VIEWS AND RECOMMENDATIONS OF THE COMMITTEE ON TRADE

55. The report of the Seminar was placed for consideration before the ECAFE Committee on Trade at its eleventh session held at Bangkok from 18 to 26 January 1968. The Committee noted that, although the Seminar did not arrive at definite conclusions on the various aspects of regional payments and there was considerable work yet to be undertaken before a concrete proposal on regional payments arrangements and the most suitable form of regional payments could be formulated, the work of the Seminar constituted a significant step toward the implementation of the resolution on dynamic Asian economic co-operation adopted at the second Ministerial Conference on Asian Economic Co-operation held at Manila in 1965. It had also distinctly advanced the thinking in the ECAFE region on this vital subject of the introduction of a regional payments mechanism as a means of promoting intraregional trade expansion.
56. The Committee had an extensive discussion on the subject. Representatives of several countries expressed substantial agreement with the conclusions and recommendations of the Seminar while some expressed doubts on the benefits of the kinds of regional payments arrangements indicated in the report. Representatives of a few countries which had not sent experts to the Seminar stated that they needed more time to complete the examination of the report.
57. The Committee agreed that, in view of the complexity of the subject matter and the far-reaching implications that a regional payments arrangement might have on fiscal and monetary policies of each country, the report of the Seminar should be thoroughly studied by the various government agencies concerned in each country, as well as by the private sectors particularly commercial banks, since the adoption of a regional payments scheme would inevitably affect the traditional modes of commercial banking practices. The Committee noted that even a sub-regional payments scheme, such as the RCD Union for Multilateral Payments Arrangements which came into force on 1 July 1967, had undergone careful examination for some years before it was adopted. It also noted that the establishment of a payments arrangement for the Association of Southeast Asia (Malaysia, Philippines and Thailand) was recommended in June 1967. It was felt that the secretariat should render technical assistance, wherever possible, to such regional and sub-regional efforts. In this connexion, reference was made to the report of the UNCTAD group of experts on payments arrangements for developing countries which concluded that "Payments arrangements in general (whether clearing

arrangements, credit arrangements or monetary unions) could make positive contribution in varying degrees towards expansion of trade among developing countries.^{1/} It was also pointed out that, apart from the technical complexity of the subject matter that had to be overcome, political will was required by interested countries concerned in the realization of such a regional co-operation project.

58. The Committee supported the Seminar's recommendation that a study of the existing international banking and credit facilities available to the region be undertaken, in co-operation with IMF, with a view to evaluating whether they adequately served the current and potential trade needs of the region. It also supported the recommendation that the secretariat undertake further detailed study of the trade and commodity structure of developing member countries with a view to identifying the products in which trade could be expanded if a programme of trade liberalization linked with some clearing or payments arrangements were introduced. These studies would facilitate technical investigations by governments and assist them in reaching policy decisions. Recalling the spirit of the Manila resolution on dynamic Asian economic co-operation, which did not consider the creation of regional payments arrangements as an end in itself but as a means toward intraregional trade liberalization and expansion, the Committee welcomed the secretariat's plan to place the above-mentioned studies together with the Seminar's report before the meeting of government trade experts on trade expansion, scheduled for Bangkok in September 1968. It was expected that the meeting would place the question of regional payments in proper perspective and would make policy recommendations for consideration by the third Ministerial Conference on Asian Economic Co-operation.

59. The Committee examined the secretariat's plan to send a mission of experts to consult with Governments, central banks, commercial banks and trade organizations in countries of the region with a view to stimulating their interests in undertaking an investigation into all aspects of clearing and payments arrangements. While representatives of several countries were of the view that the mission should be dispatched as soon as possible, without having to wait for the two above-mentioned studies to be completed, others felt that it would be rather too early to send a mission at this stage. After considerable discussion, it was generally agreed that instead of sending a mission, the secretariat might, when requested, hold informal consultations at an appropriate time in order to assist the countries in conducting technical investigations and to enable them to formulate their positions.